

INTERIM REPORT NO. 26
ONGOING INTERNAL REVENUE CODE
ISSUES RELATING TO PRESIDENTIAL
LEAVE BENEFITS

REPORT OF THE
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14 February 2008

EXECUTIVE SUMMARY

A significant contributor to San Diego's \$1 billion pension shortfall are special benefits granted unlawfully to leaders of municipal labor unions. While the Internal Revenue Service has ruled these benefits illegal, some City officials continue to seek back-door methods of funding them.

The special perks to labor leaders have not only worsened the crisis, they were part of deals in which pension benefits were given in exchange for reduced funding in violation of state fiduciary law.

Evidence has been uncovered that while San Diego was failing to adequately fund the pension plan upon which thousands of city workers depend, municipal and labor leaders were engaged in behind-the-scenes negotiations to provide special pension increases for the union presidents.

One perk provided to labor leaders allowed them to claim pension benefits based upon their union salaries, a scheme that greatly inflated their pensions from the city.

So although one union leader's city salary was \$32,700, her pension was based upon her union salary of \$90,000. This single perk – one that is illegal – boosted her pension base by more than 100 percent and added \$145,000 to the city's pension shortfall.

A similar scheme substantially boosted the pension base for the president of the Fire Fighters Union.

Yet another special benefit – one designed to retain valued city employees – was extended to union presidents, who in some cases were no longer city employees. Finally, the city also failed to deduct federal employment taxes for the perks, adding yet another potential burden to the pension shortfall.

Officials proceeded to provide these perks despite legal opinions that they were unlawful. Now the Internal Revenue Service has similarly concluded that the special benefits for union presidents are illegal - and the city must unwind these benefits at additional cost to taxpayers.

But instead of seeking a reversal of the illegal benefits, some on the city council are seeking new ways of funding them.

I.

INTRODUCTION

Substantial tax issues have surfaced regarding a pension benefit program provided to three of the City of San Diego's ("City") labor union presidents. City officials must take action to bring the City and pension system's actions within legal parameters. The San Diego City Attorney is issuing Interim Report No. 26 to inform officials as well as the public of the essential facts needed to resolve the outstanding legal issues. Those City officials who are working to circumvent the Internal Revenue Service ("IRS") rulings should halt their efforts.

Evidence in this report will show that over the course of more than 10 years, the creation of the "presidential benefit" allowed the leaders of the local City unions to participate in San Diego City Employees' Retirements System ("SDCERS") even though these individuals were on leave from their City jobs and employed by the municipal union.

The evidence in this report will illustrate the evolution of the "presidential benefit" and specifically illustrate that:

1. As early as 1989, representatives of the San Diego Police Officers Association ("POA") who left City employment were permitted to remain active participants of SDCERS. The evidence will show that this agreement was never approved by the San Diego City Council;
2. In 1996, the president of the San Diego Municipal Employees' Association ("MEA") requested the same unlawful benefit that the POA received – continued participation in SDCERS despite not being an active employee of the City;
3. The SDCERS Board of Trustees permitted the MEA president to unlawfully participate in the SDCERS pension plan beginning in 1997;
4. The SDCERS Administrator unilaterally – without approval by the City Council – permitted the unions to make payments into the pension system on behalf of the union presidents;
5. In 2001, the president of the San Diego City Fire Fighters Local 145 union also sought to inflate his future pension from the City by calculating its value based on his union pay;
6. In May 2002, the City Council agreed to allow the incumbent union presidents to inflate their City pensions by basing them on union pay. Evidence shows this Council decision was part of a transaction in which the union presidents agreed to use their influence to allow the City to pay less into the pension fund than was actuarially required, in other words under fund the plan and set the stage for has become a multi-billion dollar crisis;

7. In 2002 the City Council also agreed to pay a portion of the unions presidents' salary from the City's general fund, although union presidents work for and represent the interests of a private labor union with interests separate from those of the City; and
8. The presidential benefit was not disclosed to members of the municipal unions and was kept out of the municipal unions' contracts with the City. New union presidents were not offered the same sweetheart deal.

As discussed in the report, the U.S. Internal Revenue Service ("IRS") reviewed the operations of SDCERS and found the presidential benefit was not in compliance with federal regulations governing public pension plans. In fact, in December 2007, City and SDCERS officials agreed not to pay the union presidents these illegal benefits and to recover all prior payments. Nonetheless, certain Council members have in open session meetings expressed their intent to allocate funds from the City's coffers to pay the unlawful benefit to the MEA president.

This 26th Interim Report is issued to provide San Diegans with the record of how this presidential benefit was formulated, implemented, expanded, and eventually found illegal. Based on the evidence presented in this report, the City Attorney concludes the City of San Diego should respect the agreement it signed with the IRS and refuse to pay any and all unlawful presidential benefits.

II.

FINDINGS BY THE U.S. INTERNAL REVENUE SERVICE

On 20 December 2007, the City and SDCERS executed a Voluntary Correction Program Compliance Statement with the IRS. Pursuant to this agreement, the City and SDCERS admitted that the presidential leave retirement benefit violated the Internal Revenue Code ("IRC") and must be retroactively reversed.

Specifically, the City and SDCERS in the 20 December 2007 agreement with the IRS described the tax code failures associated with the presidential benefit and the remedy required by the IRS:

Failure #4

During the plan years that ended in 1989 through 2008, the terms of the Plan provided special retirement benefits to past and current union presidents of the San Diego Municipal Employees' Association, Police Officers' Association, and Local 145, the International Association of Fire Fighters AFL-CIO ("Unions") that were not permitted by the Code. Under Code section 401(a), retirement benefits in a qualified plan can only be provided to employees of an employer and such benefits are generally based solely on service with and compensation paid by such employer. Specifically, the following problems were noted:

(a) The Presidential Leave Program allowed former city employees who were no longer paid employees of the Plan Sponsor to continue to participate in the Plan as active participants and have their service as union presidents counted as credited service in determining retirement benefits under the Plan.

(b) From 1989 through February 2004, the Plan accepted employee and employer contributions (based upon compensation paid by the Unions) that were paid by the Unions even though they had not adopted the Plan as participating employers.

(c) Starting in 2002, the Incumbent Presidential Program allowed compensation that was paid to the union presidents by the Unions to be counted in the determination of retirement benefits under the Plan, and such amounts would be combined with any other compensation paid by the Plan Sponsor subject to a specified dollar cap.

Failure #4 (Correction)

The Plan Sponsor will amend the Plan retroactively to remove any provisions relating to Presidential Leave, including the Incumbent Presidential Program. The resulting changes to the Plan will indicate that benefits and participation under the Plan are limited to employees of the Plan Sponsor and other participating employers that have adopted the Plan and that retirement benefits would be based solely on paid compensation and service associated with the Plan Sponsor or other participating employers.

In regard to any employee contributions that were either paid to the Plan directly by the Unions or derived from compensation paid by the Unions such funds will be returned to the affected plan participants along with accumulated interest. The distribution of these monies will be a taxable distribution to each affected participant and such distribution will not be subject any favorable tax treatment under the Code. The Applicant will send a letter to each participant informing the participant that the corrective distribution is taxable, not eligible for favorable tax treatment and cannot be rolled over as normally allowed under Code section 402©. The Applicant also agrees that the distribution will be reported on Form 1099-R for the calendar year in which the distribution is made to the affected participants. The Applicant will return to the Unions the employer contributions that were paid to the Plan by the Unions.

For all impacted participants, the Applicant will recalculate their benefits under the Plan and the Plan's records will be updated to reflect reduced benefits and service credits. Retirement benefits under the Plan, including the Deferred Retirement Option Plan ("DROP"), will be determined without using any compensation paid by the Unions and any union service will also be disregarded in any computations unless such service has already been purchased by the participants under the Plan's regular service purchasing provisions. For those impacted participants who are in retirement status, the monthly annuity that is currently being paid by the Plan will be reduced to the recalculated amount. The

Applicant will recover any overpayments that have been paid to affected participants via an offset against the return of employee contributions mentioned in the preceding paragraph, by direct repayment to the Plan by the affected participants or by a special actuarial reduction to the corrected monthly pension benefit on a going forward basis.¹

After the launch of several governmental investigations, SDCERS entered the Voluntary Compliance program to bring all aspects of the pension system into conformity with federal tax laws to protect the tax deferred status of the system.²

III.

BACKGROUND

In 1996, pension board members allowed the City to contribute less than the actuarially determined amount in exchange for increased pension benefits, an action that contributed to the City's \$1.4 billion pension deficit. Judie Italiano, president of the MEA, agreed to support this unlawful proposal with the assistance of her legal counsel Ann M. Smith. In the same year, Italiano requested the City allow her to base her city pension based upon her union salary, a scheme to inflate her pension benefits.

In October 1997, the SDCERS administrator admitted in a memorandum to the pension board that the POA president had been allowed to contribute to the pension based upon his union salary since 1989. The SDCERS administrator proposed to the pension board that the MEA also be allowed to contribute to the pension fund based upon her union salary. The administrator further proposed that the pension board waive interest for the MEA purchase of service credits for past years. Although the City Municipal Code was amended to permit union presidents to buy service credits while on presidential leave, the change did not mention that contributions could be made based upon the union salaries.

In January 2001, Ronald Saathoff, president of the San Diego City Fire Fighters Local 145 union, also requested that he receive a pension from the City based upon his union pay. In May 2002 the City Council, despite the clearly unlawful nature of the transaction, agreed to allow the incumbent union presidents to calculate their city pensions based on their union pay. This Council decision was part of a transaction in which the union presidents agreed to use their influence to get the SDCERS board to allow the City to pay less into the pension system than actuarially required. These acts have led to criminal charges by both state and federal law enforcement authorities.

The City and SDCERS, as part of the IRS action of December 2007, agreed "to remove any provisions relating to Presidential Leave, including the Incumbent President Program."³

¹ 12 July 2005 SDCERS original Voluntary Compliance Program filing, Exhibit 1.

² 12 July 2005 SDCERS original Voluntary Compliance Program filing, Exhibit 1.

However, members of the City Council are now exploring the possibility of paying Ms. Italiano's presidential leave benefit from other City funds.⁴

The City Council on 8 January 2008 voted to hire an outside attorney to bring the City into conformity with the IRS Compliance Order. At the City Council meeting, Ann Smith, the attorney representing Ms. Italiano, stated that the City's outside attorney handling tax issues with the IRS order should identify a way to pay Ms. Italiano the illegal presidential benefit. Ms. Smith stated:

And I am expecting that you will get the kind of legal advice that will lead you to the right path of resolution so that the best outcome is achieved not only for the City, its taxpayers and all City employees, for each of the individuals who have been so grossly mistreated by the way this has been handled and by the outcome...And I hope thereafter you will give advice to your counsel directly or through your mayor that you expect all aspects of this compliance statement be examined, to be questioned, to be tested, and to be resolved in a manner that is fair to everyone including the people that are the most directly and most adversely impacted.

In response to Ms. Smith, Council member Jim Madaffer stated at the 8 January 2008 meeting that he would work to see that Ms. Italiano receive her president benefits. Madaffer stated:

I just want to say to Ms. Smith, I think, without revealing any confidences from closed session, the language of the motion that you see before you, I believe, embodies the spirit of many of your comments. And certainly speaking as myself, as a member of the Council, I don't think I would wish upon anybody the trauma that Ms. Italiano and the others must be going through with respect to this. At least from my standpoint, I will certainly pledge that we are going to do everything we can to make it right.

Madaffer, in effect, told Ms. Smith that he would attempt to have Ms. Italiano receive the presidential benefit from the City just days after the IRS issued a ruling that the presidential benefit was illegal according to federal tax codes.

IV.

POLICE OFFICERS ASSOCIATION PRESIDENTIAL LEAVE MEMORANDUM

³ Internal Revenue Service Voluntary Correction Program Compliance Statement pp. 2-3, Exhibit 2.

⁴ Council President Scott Peters, without the consent of the City Attorney which is required under Charter § 40, calendared a City Council agenda item to "Authorize the Mayor to negotiate an amendment to the current agreement with Foley and Lardner, outside legal counsel, for the sole purpose of reviewing and advising the Mayor and City Council on legal issues associated with the elimination of the Presidential Leave Program pension benefits in response to the IRS Voluntary Correction Program Compliance Statement." See Request for Council Action dated 22 January 2008 signed by Elizabeth Kinsley, Exhibit 3.

A 17 February 1989 memorandum from then-SDCERS Retirement Administrator Lawrence Grissom described the Presidential Leave Program in terms materially different from what the program became by late 2002. The 17 February 1989 memorandum, written to the City Auditor and Comptroller, stated that the Presidential Leave program was “an approved leave and, as such, buy back is covered by Municipal Code Section 24.0313.”⁵

The 17 February 1989 memorandum noted that employees on approved leave could buy back pension credits covering the period of their absence. They were required to request the buy back within 60 days of their return to City employment. As provided in Municipal Code §24.0313, the memorandum described the cost to buy back service credits for employees acting as union presidents and who were on leave from City service for varying periods of time:

PERIODS OF ONE YEAR OR LESS. Employee must pay the amount of employee contribution, plus interest, only. The City pickup is a portion of the employee contribution paid on behalf of the employee and is, thus, a part of the employee contribution.

PERIODS IN EXCESS OF ONE YEAR. Employee must pay the employee contributions described above, and, in addition, must pay the employer contribution.⁶

Mr. Grissom described in his February 1989 memorandum an agreement that had been reached that would allow employees on presidential leave to pay their contributions on a pay-period-by-pay-period basis prospectively:

We agreed that employees on presidential leave would be allowed to pay their contributions on a pay-period-by-pay-period basis, prospectively.⁷

The memorandum did not state, however, that employees on presidential leave would be allowed to contribute to the pension an amount based upon their higher union salaries. Handwritten notes on one copy of the 17 February 1989 memorandum suggest that the understanding was just the opposite – that the contribution was to be based solely on the union president’s former City salary. Those handwritten notes state:

1. What salary and position is the contribution buy back based on?⁸
2. At what salary is the benefit based on?

⁵ 17 February 1989 Presidential Leave Memorandum from Lawrence Grissom to Ed Ryan, Exhibit 4.

⁶ 17 February 1989 Presidential Leave Memorandum from Lawrence Grissom to Ed Ryan, Exhibit 4.

⁷ 17 February 1989 Presidential Leave Memorandum from Lawrence Grissom to Ed Ryan, Exhibit 4.

⁸ The quoted sentence may say “their” instead of “the.” This memorandum with the hand written notes came from former City Auditor Ed Ryan.

ANSWER

1. The position left and returned to, not the union position.
2. ?What did we already do with Ron Newman and Harry Eastus.

Further, the 17 February 1989 memorandum stated that contributions would be based upon the provisions of Municipal Code § 24.0313:

The basis for the calculation of these contributions will be exactly as described above; i.e., employer contributions will not be charged for the first year, but will for any period over one year.⁹

Municipal Code § 24.0313 did not provide for the union employer to set the contribution amount for payment to the pension fund. Using union salaries as the base of their pension calculations greatly inflated the amount they would receive in retirement. The memorandum stated that this arrangement was “applicable to other employee organization presidents.”¹⁰ Mr. Grissom offered, “I will volunteer to handle communicating this to those individuals and organizations,” referring to the other unions and their presidents.

V.

**MUNICIPAL EMPLOYEES’ ASSOCIATION
PRESIDENT JUDITH R. ITALIANO**

Documents show that MEA President Judith R. Italiano contacted SDCERS staff in 1996 to request that she be allowed to contribute to the pension plan on the basis of her union-determined and union-paid salary, which far exceeded her compensation as a city employee. A 9 October 1997 memorandum written by SDCERS Administrator Lawrence Grissom stated that Ms. Italiano “contacted Staff on this issue in 1996”¹¹

This information is corroborated by Ms. Italiano’s legal counsel, Ann M. Smith. Ms. Smith voluntarily testified in the criminal proceedings brought by the District Attorney against, among others, various MEA representatives. Ms. Smith testified that some time during 1996, Ms. Italiano became aware that the president of the Police Officers Association has been allowed by the City to continue to participate in the pension plan and inflate their potential benefits by using their higher union salaries.¹²

⁹ 17 February 1989 Presidential Leave Memorandum from Lawrence Grissom to Ed Ryan, Exhibit 4.

¹⁰ 17 February 1989 Presidential Leave Memorandum from Lawrence Grissom to Ed Ryan, Exhibit 4.

¹¹ 9 October 1997 Memorandum from Lawrence B. Grissom to Retirement Board Via Business Procedures Committee, Exhibit 5.

¹² Transcript *People v. Lexin* pp. 1967-1968, Exhibit 6.

Ms. Smith testified that after Ms. Italiano informed the City she knew of this arrangement for the POA, the City agreed to permit “Ms. Italiano to begin to participate again in the SDCERS plan and to make contributions based on her union-paid salary, which was what the POA was doing”¹³

To be sure, the granting of the presidential leave benefit to Ms. Italiano was a contradiction of City policy. A 25 July 1997 memorandum from Ms. Italiano to Labor Relations Manager Cathy Lexin noted that former Deputy City Attorney John Kaheny had previously advised her that she could not participate in the pension plan:

In August of 1986 I requested a leave of absence to perform the duties of MEA’s President on a full time basis. At the time of that leave, MEA’s General Manager, Dick Barker, made a request to the Labor Relations office that I be allowed to continue my City benefits while on leave and that arrangements be made for payment. The response from the Labor Relations office, which cited Attorney John Kaheny, was that there were no provisions to allow for this type of arrangement and the appearance of allowing someone to continue benefits while being compensated by the union might be seen as a “misuse or gift of public funds” (a phrase that Kaheny was famous for).¹⁴

Despite the City policy, Ms. Italiano was able to convince the City to give her the Presidential Leave benefit. Ms. Smith testified there “was at least (sic) two ordinances adopted that related to the new improvements in the pension plan that came out of the whole MP-1 set of issues, and “there was at least a line item reference in that ordinance that allowed the union president to participate.”¹⁵

Although Ms. Smith testified that Ms. Italiano learned the POA president had been permitted to participate in the City pension plan based upon union salary a document dated 18 March 2005 suggests the date was late 1995 or early 1996.¹⁶

Ordinance No. 18383, adopted 25 February 1997, added language to Municipal Code §24.0201 that allowed employees on presidential leave to pay into the pension fund.¹⁷ However, that ordinance, as amended, did not allow for future pensions to be inflated by allowing for the union presidents’ contributions to the pension system to be based upon union salaries. Thus, this ordinance did not change the City’s policy of basing pensions only on City salaries.

¹³ Transcript *People v. Lexin* pp. 1969, Exhibit 6.

¹⁴ 25 July 1997 Memorandum from Judie Italiano to Cathy Lexin, Exhibit 7; see also 21 August 1997 Memorandum from Judie Italiano to Larry Grissom, Exhibit 8.

¹⁵ Transcript *People v. Lexin* pp. 1970, Exhibit 6.

¹⁶ 18 March 2005 History of Pension Benefit For Elected MEA President, prepared by Ann M. Smith, Exhibit 61.

¹⁷ City of San Diego Ordinance No. 18383, Exhibit 9.

Therefore, Ms. Smith's testimony provided no legal justification for Ms. Italiano's pension contributions to be based on her union salary.

Union salaries cannot be used for pension purposes because the MEA and POA are not employers participating in the City's pension plan. Internal Revenue Code § 401(a) states that retirement benefits can be provided only to employees of a plan sponsor. This is a very basic rule of the Internal Revenue Code. The unions in question have not been and are not qualified plan sponsors of SDCERS. Therefore, union employees cannot participate in SDCERS.

For example, if you are not receiving a salary from the company that is the sponsor of a pension plan, why would you have any expectation of receiving a pension from that plan?

The answer is - you wouldn't. That is why, in her testimony in the criminal case, Ms. Smith was unable to identify any legal opinion to support Ms. Italiano's position that she should be able to use her union employment to earn pension benefits from the City's pension plan.

Unable to find any law to support their position, Ms. Smith and Ms. Italiano ignored the law and argued that Ms. Italiano was entitled to an increase in her pension as a matter of equity, even though the benefit was illegal. Ms. Smith explained that the participation of the POA president in the City's pension plan, raised a question of unequal treatment:

And that raised the red flag that an inequity had occurred and that what had been granted to POA's president had been denied to MEA's president, and that issue was brought to the City for redress.¹⁸

Ms. Smith, however, did not explain why such participation in the pension plan by union presidents did not raise a legal red flag, one that signaled the arrangement she was seeking would result in a clear violation of basic tax law. In other words, Ms. Italiano and Ms. Smith were keenly sensitive to issues of fairness but not the legality of this matter.

VI.

MUNICIPAL CODE CHANGED TO ALLOW UNION PRESIDENTS TO PAY INTO PENSION PLAN

The timing of Ms. Italiano's request to be treated "fairly" also likely played a role in the decision to allow her to use her union salary to inflate her pension benefits. In 1996, the year she asked to contribute to the pension based upon her union salary, Ms. Italiano agreed on behalf of the MEA to support the unlawful transaction in which increased pension benefits were exchanged for decreased City pension contributions.¹⁹ In fact, Ms. Italiano was a signatory to a 5 June 1996 agreement to support the unlawful transaction, an agreement that planted the seeds

¹⁸ Transcript *People v. Lexin* pp. 1967-1968, Exhibit 6.

¹⁹ See San Diego City Attorney Interim Report 6, *See* sandiegocityattorney.org.

of the pension crisis.²⁰ Ms. Smith represented the MEA in the negotiations that resulted in the 5 June 1996 agreement signed by Ms. Italiano.²¹

In the criminal trial testimony, Ms. Smith admitted that the provision that allowed union presidents to contribute to the pension based upon their union salary had come out of the “whole MP-1 set of issues.”²² The MP-1 agreement originated from discussions among the President of SDCERS, the San Diego City Manager, and the administrator of SDCERS.²³

In a 17 May 1996 letter, Ms. Smith wrote on behalf of the MEA and made it clear to the City that the MEA was facing “scepticism (sic) and distrust” from its members over “tampering with funding methods related to the retirement system.” MEA leaders, Ms. Smith went on to say, wouldn’t seek to win support for changing funding methods – which would lead to underfunding and financial peril for the pension plan – without significant increases in pension benefit levels for general members, along with other improvements.²⁴

In sum, the relevant documents and admissions by Ms. Smith suggest that the agreement to allow union presidents to contribute to the pension plan based upon their union salary was tied to the agreement to allow the city to make decreased contributions to the pension plan.

However, it appears that the feature allowing union presidents to make pension contributions to the pension plan based upon union salaries was omitted from the change made to Municipal Code § 24.0201. As drafted, the new Municipal Code § 24.0201 did not specify that union presidents could pay into the pension based upon their union salaries. In fact, Ms. Smith testified in the criminal proceeding that the first time the procedure was memorialized in writing for the benefit of Ms. Italiano, as MEA president, was in 2002.²⁵

If the Municipal Code did not allow Ms. Italiano and the other union presidents to use their union salary for pension purposes, how did it come to be?

It appears that a 9 October 1997 memorandum from Lawrence Grissom to the Retirement Board circumvented the Municipal Code. The purpose of this memorandum was to support Ms. Italiano’s request to allow her the ability to buy pension service credits for all the years she had been away from City service and serving full time as MEA’s president.

²⁰ 5 June 1996 Management Proposal to MEA for a FY 98 Extension of MOU, Exhibit 10.

²¹ 17 May 1996 Ann M. Smith letter to Cathy Lexin, Exhibit 11.

²² Transcript *People v. Lexin* pp. 1970, Exhibit 6.

²³ Several investigations have established that City and pension officials who participated in the making of MP-1 violated state laws. See generally San Diego City Attorney Interim Report 6, *See sandiegocityattorney.org*. See also Kroll Report pp. 1-2; 88-89, 91,93, Exhibits 12; SDCERS outside legal counsel also concluded that MP-1 violated applicable law, 13 May 2004 Seltzer Caplan Legal Opinion p. 28, Exhibit 13.

²⁴ 17 May 1996 Ann M. Smith letter to Cathy Lexin, Exhibit 11.

²⁵ Transcript *People v. Lexin* pp. 1970, Exhibit 6.

Ms. Italiano also requested that SDCERS waive \$19,805.00 in interest, which was due on the service credits she sought to purchase.

In the 9 October 1997 memorandum, Mr. Grissom explained that the POA president has been allowed to participate in the pension based upon his union salary:

In 1989, the then President of POA was allowed to purchase service credit in CERS though the normal process for purchasing LWOP service. In addition, the POA was allowed to pay normal retirement contributions, both employee and employer, on behalf of its President on an ongoing basis. These contributions are based on the age at enrollment into CERS and the salary received as President. This procedure has been in place since 1989.²⁶

In that same memorandum, Mr. Grissom also refers to a request that Ms. Italiano made for similar treatment at some time prior to 1989. This request was denied. Mr. Grissom noted that Ms. Italiano had again contacted staff on the issue in 1996 and that “ensuing discussions resulted in purchase cost calculations” and the request that SDCERS waive the interest cost for Ms. Italiano’s buy back. Mr. Grissom told the pension board it had “the authority to waive as requested, should you elect to do so.”²⁷

One authority cited by Mr. Grissom was that in the past there had been a City Council waiver of interest on service credit purchases.²⁸

Although Mr. Grissom provided what amounted to legal advice to the board that it had the authority to waive the interest for Ms. Italiano, no such legal advice from the City Attorney’s office or from SDCERS legal counsel, Loraine Chapin (also indicted) and Roxanne Parks, appeared on the record of the pension board meeting of 17 October 1997, when the interest waiver was considered by the board.²⁹

Both of these lawyers, Ms. Chapin (now indicted for her alleged involvement in 2002 increased benefits for decreased contributions transaction) and Ms. Parks, were in attendance at this meeting according to the 17 October 1997 pension board minutes.³⁰

²⁶ 9 October 1997 Memorandum from Lawrence B. Grissom to Retirement Board Via Business Procedures Committee, Exhibit 5.

²⁷ 9 October 1997 Memorandum from Lawrence B. Grissom to Retirement Board Via Business Procedures Committee, Exhibit 5.

²⁸ 17 October 1997 Transcript of SDCERS board meeting, Exhibit 14; SDCERS has been requested to provide any such waivers by public records request from the San Diego City Attorney’s office.

²⁹ 17 October 1997 SDCERS Board meeting minutes, p. 12, Exhibit 15.

³⁰ 17 October 1997 SDCERS Board meeting minutes, p. 12, Exhibit 15.

Mr. Saathoff (indicted for criminal charges), a SDCERS Board Trustee, made the motion to approve the interest waiver for Ms. Italiano. He stated that, “the City Manager’s office supports this request.”³¹ Also in attendance were Assistant City Auditor Terri Webster (indicted for criminal charges) and MEA representative John Torres (indicted for criminal charges).³² Needless to say, Mr. Saathoff’s motion was approved – and the interest was waived on benefits illegally granted in the first place.

VII.

DEPUTY CITY ATTORNEY THERESA MCATEER QUESTIONED USE OF UNION SALARY FOR SETTING PENSIONS

This section will discuss a series of communications between City officials in the Auditor’s Office, the Labor Relations Office, the City Attorney’s Office and SDCERS officials. Evidence illustrates that as late as 2001, City officials were unsure if any legislative body actually approved the practice of allowing unions to contribute to the pension system based on the union president’s salary.

On 8 January 2001, Ron Saathoff requested the City’s Labor Relations Manager permit him to participate in the City’s pension plan based in part on his union salary.³³

On 19 January 2001, Terri Webster sent a memo to Deputy City Attorney Theresa McAteer that inquired about allowing union presidents to contribute to the pension based on their union salaries. Ms. Webster was puzzled because the practice had not been “documented anywhere or authorized by the City Council” and allowed “a one year high of another employer.” Webster wrote:

Larry advised that it has been past practice (at least for 6-7 years), for MEA and POA ... not documented anywhere or authorized by the City Council to have the Unions pay the City the employers and employees contributions based on their UNION salary. Therefore in Judy’s case she will most likely retire at 55 (next years?), and her benefit will be based on her union salary \$90,000 (?) without even coming back to the City at her \$40,000 CAII (?) salary. So her retirement will be based on a one year high of another employer.³⁴

³¹ 17 October 1997 SDCERS Board meeting minutes, p. 12, Exhibit 15.

³² 17 October 1997 SDCERS Board meeting minutes, p. 1, Exhibit 15.

³³ 8 January 2001 letter from Ron Saathoff to Dan Kelly, Exhibit 16.

³⁴ 19 January 2001 e-mail from Terri Webster to Teresa McAteer, Exhibit 17.

Interestingly, Ms. Webster's letter conflicts with the action taken by the SDCERS Board in 1997 to allow union president salaries to be used to determine pension benefits.³⁵ More interesting, Ms. Webster was a SDCERS Board member in 1997 when that action was taken. However, she was confused about whether the City or SDCERS Board approved the practice.

There is a conflict between what Ms. Webster said in her 19 January 2001 memorandum and what Mr. Grissom said in his 9 October 1997 memorandum. Ms. Webster stated there was no documentation permitting the use of union salary to set pension contributions; Mr. Grissom stated the union presidents' contributions were based on union salary.

To resolve this inconsistency, Ms. McAteer sent a memorandum on 19 January 2001 seeking "such information that will be helpful to me in conducting a thorough evaluation of this issue."³⁷

Dan Kelly responded in a 14 February 2001 e-mail to McAteer and City auditors Ed Ryan and Terri Webster. Kelley wrote:

As a follow-up to our last meeting on Presidential Leave, I met with Larry Grissom and discussed the issue of Presidential Leave and retirement for Union Presidents.

Currently, MEA is paying retirement contributions for both the employer and employee for Judie Italiano based on a salary of \$90,937. That salary figure was provided to Retirement by MEA effective July 8, 2000.³⁸

Thus, Kelley confirmed the salary figure used for Ms. Italiano was her union salary. The copy of the e-mail obtained by the City Attorney's Office includes a handwritten notation stating, "who said that was ok."³⁹ This handwritten note supports the allegation that the issue was not resolved. It underscores that it was unclear who, if anyone, approved of the unions contributing to the pension based on the union-set salaries of its presidents.

Mr. Kelley wrote another memorandum on 6 April 2001 to Mr. Ryan, Ms. Webster and Ms. McAteer. In the memo, Mr. Kelley stated that, among other actions, a draft presidential benefit agreement and a memorandum of law were being prepared by the City Attorney's Office.

³⁵ The 9 October 1997 memorandum from SDCERS administrator Grissom to the SDCERS board states that the union president's contributions were based on the "salary received as President." 9 October 1997 Memorandum from Lawrence B. Grissom to Retirement Board Via Business Procedures Committee, Exhibit 5.

³⁷ 19 January 2001 e-mail from Terri Webster to Teresa McAteer, Exhibit 17.

³⁸ 14 February 2001 e-mail from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 18.

³⁹ 14 February 2001 e-mail from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 18.

The memorandum raised the possibility of a City Council briefing on 17 April 2001 concerning the presidential benefit package. Kelley wrote:

Attached is the revised language we discussed in our meeting this morning regarding the Presidential Leave Retirement Credit. As a result of today's meeting:

- 1) Gene is reviewing the Audit response.
- 2) Upon tentative approval of the Audit response from the Gene (sic), I will discuss the response with Chief Osby.
- 3) The City Attorney's Office is proceeding with the review of the draft Memorandum of Law.
- 4) We are planning on briefing Council on the Presidential Retirement Credit issue on April 17 (assuming we get in and that the Council has sufficient time to address the issue).
- 5) We are seeking costing data on the Presidential Leave Retirement Credit from SDCERS to provide to Council on the impact of creating this additional retirement benefit.
- 6) No contact will be made with the unions until the Audit response is complete.⁴⁰

Attached to the 6 April 2001 e-mail was a memorandum entitled "Presidential Leave-Payment of Retirement Benefits (Revised Language)."⁴¹ The draft memo stated in pertinent part: "A union president may have his/her retirement benefits calculated based on the high one year salary paid by the union instead of the City during presidential leave."⁴² The draft agreement stated that any purchase of service credits would be based upon either the union or city salary, whichever was higher.⁴³ Attorney McAteer signed a notice placing the item on the Council's closed session docket of 17 April 2001 for discussion and action. However, this item was taken off the agenda and the Council never considered it.⁴⁴ Therefore, the issue remained unresolved.

⁴⁰ 6 April 2001 e-mail with attachment from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 19.

⁴¹ 6 April 2001 e-mail with attachment from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 19.

⁴² 6 April 2001 e-mail with attachment from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 19.

⁴³ 6 April 2001 e-mail with attachment from Dan Kelley to Ed Ryan, Eugene Ruzzini, Terri Webster, and Theresa McAteer, Exhibit 19.

⁴⁴ 12 April 2001 Closed Session agenda, Exhibit 20; Closed Session Report for 17 April 2001, Exhibit 21.

VIII.

MEMORANDA TO CITY COUNCIL REGARDING THE PRESIDENTIAL BENEFIT ISSUE

City officials continued to issue communications showing the issue of the presidential benefit was not resolved. City officials had no record of this practice ever being approved by the City Council or the SDCERS Board. As a result, City officials began sending communications to amend the Municipal Code to approve these practices, which had occurred for more than five years.

On 28 August 2001, Mr. Kelley sent a memorandum to Cathy Lexin providing details regarding the presidential benefit package for Ms. Italiano that included her salary history for work at the City, her new union salary, and the value of her proposed pension.⁴⁵ Mr. Kelley stated that Ms. Italiano's City salary as a Payroll specialist II was \$32,678 and her union salary as of the same date was \$90,937, a 178% increase.⁴⁶

Mr. Kelley also stated that the presidential benefit for Ms. Italiano would create an unfunded liability of \$144,871 for the City. In other words, by giving the presidential benefit to Ms. Italiano, the City would have to pay \$144,871 out of the City's coffers. Mr. Kelley's memo included the amount of debt the City would take by approving the presidential benefit for the POA and Local 145. Mr. Kelley wrote that the City would be responsible for paying \$55,847 for the POA president and \$99,726 for Ron Saathoff, president of San Diego City Fire Fighters Local 145.⁴⁷

By approving these presidential benefits, the City was assuming on behalf of union presidents, for which the people of San Diego should not have to pay. The money to pay these union presidents' benefits would be taken from and drain the City's coffers, reducing funds for public services including police and fire services, park and recreation, and other general services.

Ms. Lexin drafted a memorandum to the City Council on 30 August 2001 entitled "Leave of Absence Without Pay for Union Officials and Retirement Benefit Authorization."⁴⁸ The memo, which was in draft form and never completed, included a history of the presidential benefit program and stated:

⁴⁵ 28 August 2001 e-mail from Dan Kelley to Cathy Lexin, Exhibit 22; 30 August 2001 memorandum from Cathy Lexin to Mayor and City Council, Exhibit 23.

⁴⁶ 28 August 2001 e-mail from Dan Kelley to Cathy Lexin, Exhibit 22; 30 August 2001 memorandum from Cathy Lexin to Mayor and City Council, Exhibit 23.

⁴⁷ 28 August 2001 e-mail from Dan Kelley to Cathy Lexin, Exhibit 22; 30 August 2001 memorandum from Cathy Lexin to Mayor and City Council, Exhibit 23.

⁴⁸ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

In 1989, the incoming POA President requested and was administratively authorized to pay retirement contributions on a pay-period-by-pay period basis while on 'presidential leave'⁴⁹

Ms. Lexin also wrote:

When these contributions began, they were calculated based upon the POA-paid salary as President, rather than the Police Department salary of a Police Officer/Detective.⁵⁰

Ms. Lexin wrote that she had been unable to locate any documents explaining why the union salary was used to calculate pension contributions. Ms. Lexin wrote:

We have not been able to locate any documentation explaining why the POA salary was used as the basis for calculating contributions. It is not clear whether this was an intentional change, or an unintentional occurrence. Nonetheless, this practice began in 1989 and has continued administratively with three (3) subsequent POA Presidents, virtually obscure to current City management until recently.⁵¹

Ms. Lexin's statement contradicts the knowledge she had or should have had at that time. Specifically:

- Ms. Lexin was a SDCERS trustee when Mr. Grissom wrote his 9 October 1997 memorandum stating the POA presidents' pension contributions were based on "the salary received as President."⁵²
- Minutes of the 17 October 1997 SDCERS board meeting show Ms. Lexin attended that meeting.⁵³
- The transcript of the 17 October 1997 meeting of the SDCERS Board shows Mr. Grissom stated that, as to the POA presidents, "the POA pays their salary and they have contracts on the basis of that salary."⁵⁴

⁴⁹ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵⁰ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵¹ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵² 9 October 1997 Memorandum from Lawrence B. Grissom to Retirement Board Via Business Procedures Committee, Exhibit 5.

⁵³ 17 October 1997 Transcript of SDCERS board meeting, Exhibit 14; SDCERS has been requested to provide any such waivers by public records request from the San Diego City Attorney's office.

⁵⁴ Transcript of the 17 October 1997 SDCERS board meeting, Exhibit 14.

Thus, the record before the SDCERS Board, which stated that union salaries set the pension contribution, conflicts with Ms. Lexin's representation in her 31 August 2001 draft memorandum. Rather, the memo stated the practice of pegging pension contributions to the POA salary proceeded "virtually obscure to current City management until recently."⁵⁵

Ms. Lexin also discussed the pension benefits for Ms. Italiano in the 30 August 2001 draft memorandum. Ms. Lexin wrote that the provision to allow union presidents to buy service credits while employed by their union had been part of the implementation of benefits enhancements in 1997. Ms. Lexin wrote that Ms. Italiano had contributed to the pension plan based upon her union-determined salary. She wrote that City management had not known the contributions were based upon Ms. Italiano's union salary.⁵⁶

The current MEA President has held this office since 1986 and has been on an approved Leave of Absence Without Pay from the City for this entire period. During labor negotiations in 1997, a number of retirement benefit enhancement were implemented. As part of these changes, a specific provision was added to the Municipal Code 24.0201 (c), attached, authorizing the duly elected president of a recognized labor organization to continue making retirement contributions to SDCERS while on "Presidential Leave." In 1997, the President of MEA exercised this feature, purchased service from 1986 through 1997, and began making prospective retirement contributions. What was not apparent to City management was that these contributions, like the POA President, were calculated based upon the MEA-paid salary for their President.⁵⁷

Ms. Lexin also wrote that Fire Fighter Union President Ron Saathoff had requested a "modified" version of the presidential leave benefit.⁵⁸ Ms. Lexin specifically addressed the expectation of the union presidents:

The retirement formula for City employees is established by the City Council in the Municipal Code, and includes a factor, the employee's highest one year salary. It has become apparent that the past practice for twelve (12) years with POA, and four (4) years with MEA of accepting contributions based upon Union salary, has created an expectation that the Union President's employee's retirement benefit will be based upon their Union salary, should that be their highest one year salary.⁵⁹

⁵⁵ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵⁶ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council Exhibit 23.

⁵⁷ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵⁸ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁵⁹ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

Ms. Lexin then turned to the alternatives before the Council. The option required under the law was presented as an “Alternative” and the option outside the law was presented as a recommendation. Lexin wrote:

RECOMMENDATION

It is recommended that the City Council amend the Municipal Code to allow a duly elected President of a recognized labor organization who is granted a Leave Without Pay, whether full time or in the part-time manner proposed by Local 145, the option of (1) continuing contributions to SDCERS based upon their salary at the time of Leave, or (2) making contributions based upon the Union-paid salary as President, or (3) making contributions based upon the combination of employee salary and Union-paid salary as in the case of Local 145. ***

ALTERNATIVE

1. Notify MEA and POA Presidents that they have been contributing an inappropriate retirement contribution, refund the overpayments, and advise the employee/Presidents that the City will not consider the Union-established salary in determining high one year for retirement benefit calculations. It is relatively certain that this would generate litigation.⁶⁰

2. For Local 145 President, (memorandum unfinished)

However, Lexin’s draft memorandum was unfinished. There are two other drafts, dated 26 November 2001 and 12 December 2001. Both versions appear to be complete and contain new information. New information in the later drafts includes a statement to the effect that no past union president had retired. Lexin wrote:

It should be noted that, to date, there have been no unauthorized retirement payments made to any past union president since no union president has retired from any position other than a City position.⁶¹

The November and December versions of the Lexin memorandum provided two options:

Blended High One Years Methodology:

This method, recommended by the City Manager, provides for a ‘Blended high one year calculation’ methodology which utilizes the applicable High One Year Salary based on the number of years of service in each of the Union President’s employee positions (City employee, or Union President, or the City employee/Union President service together, as may be the case) in consideration of the retirement contribution made relative to the specific position. There is no

⁶⁰ 30 August 2001 Cathy Lexin memorandum to Mayor and City Council, Exhibit 23.

⁶¹ 26 November 2001 and 12 December 2001 memorandums from Cathy Lexin to the Mayor and City Council, Exhibits 24 and 25.

additional cost or unfunded liability to SDCERS associated with the *Blended* methodology.

Combined High One Year Methodology:

This method, sought by the Union Presidents, applies a 'Combined high one year calculation methodology' which utilizes the total highest one year salary attained as either the Union President, or the Combined total salary as Union President AND City employee irrespective of whether sufficient contributions have been made to the SDCERS to support such a proposed benefit calculation. The SDCERS Administrator estimates the unfunded liability for the Combined High One Years Methodology to be approximately \$300,000 for the current union presidents.

The attachments (1-3) provide a comparison of the benefit differential which occurs between the Blended High One Year Methodology and the Combined High One Years Methodology.⁶²

In the November 2001 and December 2001 memoranda, Ms. Lexin changed the recommendation from the August 2001 memorandum.

In August, Ms. Lexin recommended the Council allow union presidents to use their union salary to set their high one year with a cap.⁶³ In November and December, she recommended Option I the Blended High One Year Methodology with a cap⁶⁴ and included calculations of what the union presidents would receive under the two alternatives.

- For Ms. Italiano, calculations showed that under the blended method recommended by Ms. Lexin, Ms. Italiano would receive \$25,500. Under the combined recommendation sought by Ms. Italiano, she would receive \$54,779 or an increase of \$29,278 – a 114% difference.⁶⁵
- For the POA president, the amount was \$40,256 under the Lexin recommended blended rate and \$62,545 for the combined method.
- For Mr. Saathoff, the blended method would provide \$60,500 and the combined method \$86,053, or a \$25,552 difference.⁶⁶

⁶² 26 November 2001 and 12 December 2001 memorandums from Cathy Lexin to the Mayor and City Council, Exhibits 24 and 25.

⁶³ 30 August 2001 Cathy Lexin e-mail to Mayor and City Council, Exhibit 23.

⁶⁴ 26 November 2001 and 12 December 2001 memorandums from Cathy Lexin to the Mayor and City Council, Exhibits 24 and 25.

⁶⁵ 26 November 2001 and 12 December 2001 memorandums from Cathy Lexin to the Mayor and City Council, Exhibits 24 and 25.

⁶⁶ Note the calculations for the POA president and Mr. Saathoff do not appear in the version of the Lexin memorandum obtained by the City Attorney; 12 December 2001 memorandums from Cathy Lexin to the Mayor and City Council, Exhibit 25.

It is clear the union presidents stood to make significant gains to their pensions if the presidential benefit were approved.

Meanwhile, new calculations were prepared for Ms. Italiano, the POA president, and Mr. Saathoff. An e-mail from SDCERS administrator Lawrence Grissom to Mr. Kelley regarding “Costing of Retirement Proposal” substantially increased the benefit calculations:

- Italiano-retire at age 61 with 30 years= 70.5% Salary=\$98,290.4 x 70.5%=\$69,294
- Farrar-retire at age 55+ with 30 years=90% Salary= \$79,271.92 x 90%=\$71,344
- Saathoff-retire at 55+ with 30 years +90% Salary = \$114,964 x 90% = \$103,468

Thus, the three union presidents would receive vastly higher pensions. Ms. Italiano’s pension would increase to \$69,294 annually, as opposed to the \$25,500 she would have received using the “blended” method, or \$54,779 she would have received under the “high one year” salary approach.

The POA president’s pension would increase to \$79,271 annually, as opposed to the \$40,256 he would have received using the “blended” method, or \$62,545 he would have received under the “high one year” salary approach.

Mr. Saathoff’s benefit would increase to \$103,468 annually, as opposed to the \$60,500 he would have received using the “blended” method, or \$86,053 he would have received under the “high one year” salary approach.⁶⁷

The following table details the benefits described above:

| Union President | Blended | High One-Year 12/01 | High One-Year 11/01 |
|------------------------|----------------|--------------------------------|--------------------------------|
| Ms. Italiano | \$25,500 | \$54,779 | \$69,294 |
| POA President | \$40,256 | \$62,545 | \$79,271 |
| Mr. Saathoff | \$60,500 | \$86,053 | \$103,468 |

It is clear the union presidents stood to gain the most financially with approval of the “High One Year 11/01” calculation.

IX.

UNION PRESIDENT RON SAATHOFF’S PRESIDENTIAL LEAVE BENEFIT RAISES NEED FOR RULING BY INTERNAL REVENUE SERVICE

⁶⁷ 9 November 2001 e-mail from Lawrence Grissom to Dan Kelley, re: Costing of Retirement Proposal, Exhibit 26.

The presidential leave benefit enjoyed by firefighter union president Ron Saathoff raised tax questions as well. This section will address those tax implications.

On 13 March 2002, City labor negotiator Dan Kelley wrote an e-mail to City Auditor Ed Ryan about a proposal by Mr. Saathoff to have his union reimburse the City for certain union-related work. Mr. Kelley's e-mail discussed the need for a ruling by the Internal Revenue Service:

3. Until the City receives approval from the IRS permitting the City to be reimbursed by Local 145 for the remaining 40% or more of presidential leave time at 140% of the normal rate for compensation, Local 145 shall have the responsibility for compensating the president directly. The City will make a good faith effort to obtain a ruling on this issue as soon as possible.

4. The City through its Management Team will support any necessary changes to the Civil Service Rules and the Rules of the Retirement System to authorize the above-described arrangement, including a provision permitting union presidents to remain full-time contributing active members of the City Employees Retirement System even when working less than half-time for the City - on the condition that the union bears the cost of the benefit coving presidential leave time either through reimbursement to the City or by direct payment.⁶⁸

Despite Mr. Kelley's e-mail warning the City through its auditor that an IRS ruling was necessary to permit the reimbursement scheme, the City apparently did not seek a ruling.

X.

POA PRESIDENT'S ENTRY INTO DEFERRED RETIREMENT PROGRAM RAISES ISSUE OF USE OF UNION SALARY

By the end of March 2001, the POA president made an appointment with SDCERS staff to complete his application to enter the City's deferred retirement program (known as "DROP"). The purpose of DROP was to keep City employees in their City jobs after retirement age, because it was thought this would be a cheaper and better alternative to hiring and training new employees.

Under the terms of the program, an employee "retires" for purposes of accumulating additional retirement benefits, but remains an active City employee for up to five years. While the employee is in DROP, his retirement benefit payments are paid into a special account for the employee's benefit. When the employee leaves City employment and the DROP program, he can withdraw the money from that special account in a single lump sum, withdraw it in even payments over a set amount of time, or leave the funds on deposit with SDCERS.

⁶⁸ 13 March 2002 e-mail from Dan Kelley to Ed Ryan, Exhibit 27.

With regard to the union presidents, DROP was a misnomer. DROP clearly was not designed to keep City union presidents in their union positions after reaching retirement age. When the POA president attempted to enter DROP, City employee Judy Zellers informed the POA president there was no legal authority permitting him to do so:

As we discussed, Bill Farrar, POA President, has an appointment to enter the DROP program on April 9th. His retirement allowance would be calculated at that date. Vincent asked if our review would be completed by then and I told him it would not be. During our meeting, Vincent mentioned the plan was to base Farrar's allowance on his high 1 year salary, including the Union paid salary. I told Vincent that I did not think there was a legal basis for doing this. After discussions, Vincent said he would take the issue to Legal for review. I told him we would send him an e-mail on the issue stating our views.⁶⁹

The issue of union presidents participating in DROP was eventually resolved: The City Council adopted a resolution allowing union presidents to participate in DROP based on their union salaries. However, like the presidential benefit, the IRS later found that this "perk" violated the Internal Revenue Code. In December 2007, the City and SDCERS agreed to retroactively set it aside.

XI.

SAN DIEGO CITY COUNCIL DISCUSSES PRESIDENTIAL BENEFIT ISSUE BEHIND CLOSED DOORS

This section addresses the change in position by the City's Management Team regarding Mr. Saathoff's potential use of his union salary to calculate his pension benefits.

The San Diego City Council Closed Session Report for 30 April 2002 shows the City Council unanimously approved the City Manager's recommendation to "base retirement on the high one-year union salary" for city union presidents.⁷⁰ A PowerPoint presentation dated 29 April 2002, designed to update the Council and Mayor in closed session on the meet and confer process, described the Management Team's Recommendation:

Authorize inclusion of union salary in high one-year calculation; establish a maximum retirement high one-year salary at level equal to City Labor Relations Manager (approx. \$108k)⁷¹

⁶⁹ 28 March 2002 e-mail from Judy Zellers to Kyle Elser, Exhibit 28; see also e-mails between and Kyle Elser, Paul Barnett, and DM Truver between 29 March and 6 April 2002, Exhibit 29; also see 10 April 2002 letter from POA letter to Lawrence Grissom, Exhibit 30.

⁷⁰ 30 April 2002 San Diego City Council Closed Session Report, Exhibit 31.

⁷¹ 29 April 2001 Meet and Confer Power Point Closed Session no. 49, Exhibit 32.

The same presentation contained another Management Team Recommendation specific to Mr. Saathoff, the firefighters union president, to “not authorize inclusion of union salary in high one-year calculation.[emphasis added]”⁷²

On 30 April 2002, City officials granted two union presidents’ requests to use their union salaries to calculate their City pensions. Permitting union employees to participate in the City pension raised tax questions.

To address these tax law questions, the City retained attorney Michael J. Changaris to issue an opinion.⁷³ On that same day, former Assistant City Attorney Leslie Devaney left a phone message seeking advice: “Mike Changaris Tax Attorney 515-3252 Leslie Devaney wants you to call him directly re Union President being paid by City and tax implications. He is expecting your call.”⁷⁴

The 6 May 2002 City Council Closed Session Report shows the Council unanimously approved permitting Mr. Saathoff to use his union salary to set his pension. The motion to approve Mr. Saathoff’s use of union pay for his city pension was made by District 7 Councilmember Jim Madaffer. The PowerPoint presentation for the meeting showed the Management Team recommendation was to “Authorize including of union salary in high one year calculation; establish a maximum retirement high one-year salary at level equal to City Labor Relations Manager (approximately \$108,000 currently).”

Just one week before, the Management Team recommendation had been to not authorize use of the union salary to set Mr. Saathoff’s City pension. (Compare the original Management Team recommendation of 30 April 2002 to the 7 May 2002 recommendation in support of allowing Mr. Saathoff to use his union salary.)⁷⁵ The closed session vote was recorded by Assistant City Attorney Leslie Devaney.

XII.

OUTSIDE LEGAL OPINION BY TAX COUNSEL WARNED THE CITY OF IRS RISKS

An outside legal opinion warned the City in 2002 of the risk it was taking in treating the union officials as though they were City employees.

⁷² 29 April 2001 Meet and Confer Power Point Closed Session no. 52, Exhibit 32.

⁷³ See profile of Michael J.Changaris, Exhibit 33; 13 May 2002 letter from Mr. Changaris to Leslie E. Devaney, Exhibits 34.

⁷⁴ 30 April 2002 2:08 phone message, Exhibit 35.

⁷⁵ 6 May 2002 San Diego City Closed Session Report and related power point presentation no. 38, Exhibit 36.

On 13 May 2002, six days after the City Council approved the use of union salary to set City pension benefits, outside tax counsel issued a warning to City officials through a letter to former Assistant City Attorney Leslie Devaney.⁷⁶ The tax advice was directed at a City plan to treat *future* union presidents as City employees.

The City plan was to pay union presidents as if they were City employees. Outside counsel generally opined that, even if the City paid union presidents at their City salary, they were still considered to be union employees. In other words, the union was still considered to be the union president's employer. But the union was not an employer participating in the City's pension system. Therefore, union presidents employed by the union were not eligible to participate in the City's pension plan during the time they were not City employees.

The tax letter dated 13 May 2002 made clear that even if the City paid the union presidents, they were still employees of their labor union:

As described in more detail below, you have advised that the City is considering a proposal which will result in certain City employees becoming full-time union ("Union") representatives for a period of time, and during such period they will not be performing City-related services. I have referred to these individuals below as 'Union Presidents.' You have asked for our advice regarding the Federal income tax implications if these employees continue to draw their salaries from the City, and not the Unions. Our advice in this regard is provided below.

The letter also warned of additional liability for the City's course of action. In its conclusions and recommendations, it stated:

Based on the facts and assumptions described below, there is a substantial risk that the Service would conclude that, for Federal income tax purposes, while City employees are acting as Union Presidents, they are employees of the Unions. In that event, it is not only permissible, but required under Federal Income tax laws that the City withhold taxes from wages paid to Union Presidents, and the taxes to be withheld would include so-called 'employment taxes.'⁷⁷

A Private Letter Ruling cited in the tax lawyer's opinion letter of 13 May 2002 found that an employee who was permitted to participate in a government pension plan, ordinarily exempt from taxation, was required to pay taxes on the amounts she contributed to a state pension plan. This is of particular relevance here:

For example, in Private Letter Ruling 9252005 (September 21, 1992), a public school teacher (otherwise exempt from employment taxes as an employee of a state, political subdivision or instrumentality thereof) took time off from her school teaching duties in order to act as a full-time representative of an employee

⁷⁶ 13 May 2002 tax opinion letter to former Assistant City Attorney Leslie E. Devaney, Exhibit 34.

⁷⁷ 13 May 2002 tax opinion letter to former Assistant City Attorney Leslie E. Devaney, Exhibit 34.

organization (a union). The employee was on an unpaid leave of absence from the school, but still was credited with services under the state's retirement system, and was required to make contributions into the system. Nevertheless, recognizing that the only person the employee was performing services for was the union, the Service held the union was the employer, and wages paid to her were not exempt from employment taxes.⁷⁸

The decision to permit union officials to participate in the City pension plan when they were not City employees, or for work not done for the City, was found by the IRS to be a clear violation of Internal Revenue Code 401(a). Thus, the City, SDCERS and the unions must unwind the transactions. The tax letter opinion made clear that union employees were not city employees at the time the City Council approved the decision.

Moreover, the City Attorney documented the fact that, as to future union presidents, the Mayor and City Council had made a "policy decision" to not withhold taxes as suggested by outside counsel:

A policy decision was made by the Mayor and City Council to follow the position stated in the opinion to not take out federal taxes pursuant to FICA and to request and receive protective indemnity language from the respective Unions.⁷⁹

XIII.

PRESIDENTIAL BENEFIT CONTINGENT ON SDCERS RELAXING CITY'S BALLOON PAYMENT

This section addresses the relationship between the presidential benefit and the City's scheme to underfund its pension system.

At the time the Council considered allowing the MEA and fire fighters union presidents to receive City pensions based on their union work, the Council also was approving a proposal to allow the City to pay less than the actuarially required amount into the City pension system.⁸⁰ But the Council's calculated plan to underfund its pension obligations first had to win approval by SDCERS trustees.

Conveniently, the SDCERS Board included fire fighters union president Ron Saathoff and MEA members. In addition to the presidential benefit for Mr. Saathoff and MEA president Judie Italiano, the Council approved an increase in the per-year formula for the City's general employees. Both of these new benefits were contingent upon the SDCERS board approving a

⁷⁸ 13 May 2002 tax opinion letter to former Assistant City Attorney Leslie E. Devaney, Exhibit 34.

⁷⁹ 17 June 2002 legal memorandum to the City Council from former City Attorney Casey Gwinn, Exhibit 37.

⁸⁰ See Interim Reports 2, 3, 6, and 19 at sandiegocityattorney.org.

proposal to further underfund the pension. The City meanwhile was facing a balloon payment, because the funding level of the pension fund had dropped below the point triggering such a payment.

Several of the trustees stood to benefit from the general member increase. Councilmembers Jim Madaffer and Toni Atkins also stood to benefit, because they were employed as City employees prior to their service on the City Council. Thus, these new benefits would be applied retroactively to their pensions.⁸¹

E-mails on 21 May 2002 shed light on the role Mr. Saathoff would play in swaying the SDCERS board, of which he was a member, to relax the contribution requirements in favor of the City. One of the e-mails, written by City Auditor Terri Webster, said Mr. Saathoff “runs the show at CERS.” The documents show the presidential benefit was contingent on the decision by the SDCERS board to relax the trigger that would require the City to make the pension balloon payment. The e-mail exchange was between SDCERS trustee and City Auditor Terri Webster and the City’s labor relations office:

(From Terri Webster)

Dan

The Local 145 write up you sent out did not state that their increased offset was contingent on the Board taxing the trigger ... I thought ALL retirement improvements (including the presidential leave (?)) were contingent on the trigger ... especially need Ron behind releasing the trigger since he runs the show at CERS

(From Mike McGhee)

Dan shared with me your comments Terri. I assure you that Ron is well aware of the contingent nature of the benefits, after our repeated statements at the negotiating table regarding the benefits being contingent upon your noted approvals. Cathy was very specific on those points at every discussion. The various proposals are all specific to the necessary approvals and available funding from the reserves, although this is not stated in this ‘highlights’ to the departments.⁸²

The 26 April 2002 MEA Counterproposal to the City’s 26 April 2002 Offer made clear the MEA had accepted the contingency that benefit increases were conditioned upon SDCERS allowing the City to illegally under fund the pension plan.⁸³ The MEA Counterproposal provided expressly that: “With regard the retirement formula improvement for general members, MEA accepts the contingency regarding approval by the Retirement Board of Administration on the terms stated, including the making of an appropriate downward adjustment in the funding level

⁸¹ See Interim Reports 2, 3, 6, and 19 at sandiegocityattorney.org.

⁸² 21 May 2002 e-mails from and to Terri Webster and Mike McGhee, Exhibit 38.

⁸³ 26 April 2002 MEA Counterproposal Exhibit 39.

percentage 'trigger' under the 'corridor plan;' however, MEA does not agree with the proposed 70% 'trigger,' believing instead that an adjustment to 80% from the current 82.3% is the maximum necessary to address the City's legitimate concerns."⁸⁴

A 1 July 2002 MEA "Hotsheet" expressly stated that new benefits were contingent on SDCERS giving the City pension contribution relief:

The availability of these benefit improvement depends on a favorable vote of the Retirement Board of Trustees on the City's request for a payment plan, which would lower the current 'trigger' from 82.3% to 75%.

The Retirement Board of Trustees will meet July 11th at 9:00am at 410 B Street, Suite 400. Please attend this meeting-we need your support.⁸⁵

A 12 July 2002 MEA Hotsheet announced the City Manager had told the MEA that, based upon the action of the SDCERS board at its 11 July 2002 meeting, the contingencies had been made:

Thursday July 11th the San Diego Retirement Board of Trustees approved the City Manager's request to allow the City to ramp up their contributions over the next 7 years. This will give the City some relief in an already tight budget year and it will allow them to work with the Retirement Board in preparing for increases in employer contributions.

This arrangement will be voted on in closed session by the City Council but City Manager Mike Ubergaga has informed MEA that he 'motion approved by the Retirement Board was within the authority the Council had given him.' And therefore he felt the contingencies of our ratified agreement had been met and we had an agreement. This means the negotiated retirement benefit improvement will be approved retroactive to July 1, 2002.⁸⁶

Although two MEA members served on the SDCERS board, no precautions were taken to safeguard to prevent Ms. Italiano from receiving preferential treatment. In 1996, when she went before the board for approval of her participation in the pension plan based upon her union salary, two members of the SDCERS board (John F. Casey and John A. Torres) were MEA members.

When the first increased benefits/decreased contributions deal was struck with SDCERS on 21 June 1996, there were two MEA members on the SDCERS board (Mr. Torres and Mr. Casey). When the second increased benefits/decreased contribution deal was struck on 11 July 2002, there were two members of MEA on the pension board (Mr. Torres and Mr. Casey). In

⁸⁴ 26 April 2002 MEA Counterproposal Exhibit 39.

⁸⁵ 1 July 2002 MEA Hot Sheet, Exhibit 40.

⁸⁶ 12 July 2002, MEA Hotsheet, Exhibit 41.

each instance, Mr. Torres and Mr. Casey voted in favor of Ms. Italiano and the increased benefits and decreased contribution deals.⁸⁷

XIV.

INDEMNIFICATION ASSOCIATED WITH PRESIDENTIAL LEAVE

Outside legal counsel who reviewed the presidential leave proposal for *future* union presidents recommended that the City seek indemnification from the unions. Officials were still sufficiently concerned to inquire of legal counsel about whether a failure to withhold employment taxes could result in criminal liability.

Outside tax counsel advised the City to secure an indemnification from the unions for the City's decision to *not* withhold employment taxes for union presidents paid by the City but employed by the unions:

In the event that, in order to facilitate current negotiations with the Unions for new labor relations agreements, the City is willing to take a more aggressive tax position to the effect that Unions Presidents continue to be City employees for Federal income tax purpose, the City should require that the Unions indemnify and hold the City harmless from all taxes, interest and penalties arising from a contrary determination by the Service, together with all other costs and expenses related thereto.⁸⁸

Former City Attorney Casey Gwinn advised the City Council that, with the decision to not follow outside counsel's approach to withhold taxes for union presidents, the City had requested and received an indemnification agreement from the unions:

The indemnity provision is included in paragraph six of the attached draft Presidential Leave proposal. This indemnity language will provide the Auditor and Comptroller, Personnel Director and the City absolute protection from any potential civil liability. There is no criminal liability exposure for not withholding federal taxes pursuant to FICA. Also, as you know, the Mayor and City Council, as well as the Unions, agreed to indemnify the Auditor and Comptroller and Personnel Director.⁸⁹

⁸⁷ 21 June 1996 SDCERS board meeting minutes, Exhibit 42; 17 October 1997 SDCERS board minutes, Exhibit 15; MEA MOU pages showing Mr. Casey and Mr. Torres were MEA members, Exhibits 43.

⁸⁸ 13 May 2002 tax opinion letter from outside tax counsel to former Assistant City Attorney Leslie E. Devaney, Exhibit 34.

⁸⁹ 17 June 2002 legal memorandum to the City Council from former City Attorney Casey Gwinn, Exhibit 37; see 11 June 2002 and 14 June e-mails from former Deputy City Attorney Elmer Heap to Ed Ryan, Exhibits 44 and 45; and

XV.

THE SDCERS BOARD OF TRUSTEES DID NOT REVIEW THE PRESIDENTIAL LEAVE ISSUE

The presidential leave issue was concealed from the SDCERS Board of Trustees.

On 6 September 2002, the City Council's draft resolution for the presidential benefit for the incumbent president was sent to Labor Relations Chief Cathy Lexin and Auditor Ed Ryan, as well as SDCERS lawyers Loraine Chapin and Roxanne Story Parks. The draft resolution recited terms of the presidential benefit that allowed the union presidents to participate in the City pension plan based upon their union salaries. The draft resolution stated "the Retirement Board has approved the above-stated actions."⁹⁰

The e-mail enclosing the draft resolution was sent at 8:59 a.m. on 6 September 2002. Within a few hours, SDCERS lawyer Loraine Chapin wrote back: "The Board had not reviewed the Presidential Leave issue and does not have to. The Resolution on the top of page 3 indicates the Board has approved. This whereas should be deleted."⁹¹

Ann M. Smith, counsel for the MEA and its president, Judie Italiano, was also involved in drafting the presidential benefit resolution. A 17 September 2002 e-mail from Dan Kelley stated: "Please send me your final incumbent Presidential Leave Resolution so I can forward to the three affected union presidents and Ann Smith for final review."⁹²

XVI.

COUNCIL APPROVES PRESIDENTIAL BENEFIT FOR INCUMBENT UNION PRESIDENTS

On 7 October 2001, a Request for Council Action was prepared calling for the preparation of a resolution to "authorize the Retirement Benefits and Retirement Contributions for incumbent presidents for MEA, POA and Local 145. The incumbent president item was scheduled on the same day as the labor agreements for city workers."⁹³

3 August 2004 memorandum from former Assistant City Attorney Leslie J. Girard to Rich Snapper, Personnel Director, Exhibit 46.

⁹⁰ 6 September 2002 e-mail from Michael Rivo to Cathy Lexin, et al, Exhibit 47.

⁹¹ 6 September 2002 e-mail from Loraine Chapin to Cathy Lexin et al, Exhibit 48.

⁹² 17 September 2002 e-mail from Dan Kelley, Exhibit 49. See also 7 October 2002 e-mail to Dan Kelley stating that a part of the resolution "was revised by Ann Smith's suggestion," Exhibit 50.

⁹³ 1472 Request of Council Action dated 7 October 2002, Exhibit 51.

On 21 October 2001, the City Council adopted the presidential benefit for incumbent presidents as Item 111 Subitem-A.⁹⁴

MEA counsel Ann M. Smith later testified in a criminal case involving the presidential benefit. In her testimony, she said the 21 October 2002 resolution set forth Judie Italiano's deal. However, the City Council had not approved the arrangement Ms. Italiano had made with some City and City pension officials. There was no written agreement, however, prior to 2002 and no formal Council action prior to 2002 approving Ms. Italiano's pension benefits.

Here is how Ms. Smith testified during the criminal case against former MEA and other members of the SDCERS board:

My only hesitation is to make clear on the record that what was memorialized here was, in fact, except for the imposition of the cap, which was not arguably favorable to Ms. Italiano, but what was memorialized here had already been the agreement in effect and being executed since late 1997. It was not a new benefit for Ms. Italiano as it was later proclaimed to be by certain people.⁹⁵

XVII.

THE CITY IS TOLD THE INCUMBENT PRESIDENTIAL BENEFIT VIOLATES TAX LAW

On 29 October 2004, SDCERS advised then-City Manager Lamont Ewell that SDCERS' outside legal counsel had determined the incumbent president plan that allowed City union presidents to participate in the City's pension system violated tax law.⁹⁶

The 29 October 2004 memorandum from the SDCERS administrator provided in pertinent part:

In October 2002, the City Council passed resolution #297212, regarding the retirement benefits to accrue for City employees who are serving as presidents of their respective unions. The San Diego City Employees' Retirement System has received contribution (on behalf of all of the affected individuals, except the President of Local 145) from their respective unions based upon their salary as Union President. At this time, Ron Saathoff, President of Local 145, has entered

⁹⁴ See 21 October 2002 San Diego City Council Minutes p. 30; and Resolution 297212 dated 21 October 2002, Exhibits 52 and 53.

⁹⁵ Transcript *People v. Lexin* pp. 1967-1968, Exhibit 6.

⁹⁶ 29 October 2004 memorandum from Lawrence Grissom to Lamont Ewell, Exhibit 54; the POA president was able to secure Council approval of his DROP application, 13 June 2002 memorandum from Cathy Lexin to Mayor and City Council; 16 July 2002 Closed Session Report, Exhibit 55.

the DROP program and we have applications from Judie Italiano, President of MEA, Bill Farrar, President of POA, and Gary Collins, past President of POA, to enter the DROP program.

In light of this situation, coupled with the request of one or more of the above individuals to make the contributions to the DROP program on a tax deferred basis, we felt it prudent to refer the issue of these benefit to our outside tax counsel for review. In summary, they have indicated that SDCERS should not have accepted contributions from any union on behalf of its president, because a union does not meet the tests specified by various Federal agencies as a governmental employer.

Accordingly, tax counsel has advised us that we should refund all such contributions to the respective unions. It is their advice that not to do so, to continue to accept contributions from that source, or to pay benefits based upon contributions thus received, would endanger the tax qualified status of the plan. In this situation, we have no option other than to follow the advice of tax counsel.⁹⁷

Despite this dire warning, this advice was not followed. Rather, SDCERS continued to operate the presidential benefit for incumbent presidents for three years, even with the knowledge it was unlawful to do so.

XVIII.

CITY AND SDCERS IMPLEMENT PRESIDENTIAL BENEFIT FOR NEW UNION PRESIDENTS

Despite the illegality of the presidential benefit, the unions and the City memorialized the arrangement in 2002. The presidential benefit for future presidents was added to Municipal Code § 24.0201 for General Members of the pension plan and § 24.0301 for Safety Members of the pension plan: "A member who is serving as the duly elected president of a recognized employee labor organization may continue to participate in the retirement system, consistent with the governing memorandum of understanding between the city and the member's employee organization."⁹⁸

The presidential benefit provisions were added to the MEA and Fire Fighters memoranda of understanding in 2002. The POA presidential benefit section was added to the POA memorandum of understanding in 2003.⁹⁹

⁹⁷ 29 October 2004 memorandum from Lawrence Grissom to Lamont Ewell, Exhibit 54.

⁹⁸ Municipal Code § 24.0201(b) for General Members and §24.0301(b) for Safety Members, Exhibits 56 and 57.

⁹⁹ MEA Memorandum of Understanding; Fire Fighter Memorandum of Understanding; and POA Memorandum of Understanding, Exhibits 58 , 59 and 60.

Presidential Leave for MEA was added as Article 15 of the MEA memorandum of understanding, Article 45 for the Fire Fighters, and Article 65 for POA. Each of the provisions for presidential benefits in the three memoranda of understanding contained identical provisions:

1. The President will remain a full-time City employee receiving a salary equal to the salary the President is receiving at the time he or she takes office. This amount will reflect the base pay the President receives as calculated for retirement purpose and will not include any add-ons that are not part of the retirement calculation. During Presidential Leave, the President will receive raises commensurate to the raises of employees in his or her classification.
2. The President will maintain all the rights and benefits of a City employee. During normal work hours the President shall be subject to all applicable provisions of law, including all the policies and procedures of the City, all terms and conditions contained in this Memorandum of Understanding, and the affidavit of adherence referenced in paragraph 7 below. Normal work hours means 8:00 a.m. to 5:00 p.m. Monday through Friday, or an equivalent schedule approved in advance by the City Manager.
3. The President will be covered by the City's Workers Compensation Plan for any injuries incurred while the President is performing representational activities during normal work hours as defined in paragraph 2 above. Worker's compensation benefits will not cover travel time to and from the President's home to his or her primary workplace, or to and from social activities from any location, but will cover travel time to or from representational meetings during normal work hours.
4. MEA will indemnify, defend, and hold harmless the City, and its employees and agents, for any liabilities, including costs and attorney's fees, resulting from any conduct by the President in violation of any federal, state or local law, or any City policy or procedure, including but not limited to Council Policies, Administrative Regulations, Personnel Regulations, Administrative Manuals, or Department Directives, Policies and Procedures.
5. [NAME OF UNION] will indemnify, defend, and hold harmless the City, and its employees and agents, for any liabilities resulting from the City's not withholding employment taxes pursuant to the Federal Insurance Contributions Act (FICA) from the President's wages, including but not limited to the obligation to pay those employment taxes determined to be due (both the employee and City portions), interest on the late payment of those taxes, penalties for failure to timely file, pay, withhold and remit the taxes, plus cost and attorney's fees
6. An employee on approved Presidential Leave will submit his/her bi-weekly time card in a timely manner to the Labor Relations Manager of his/her designee for authorization signature. The bi-weekly time card will then be

forwarded to the Manager's Payroll Specialist for processing and transmission to Personnel for review and the Auditor and Comptroller for payment.

7. The Union President may enter Presidential Leave by providing notice of such election to the City Manager/Labor Relations Office and executing an affidavit of adherence to the provisions of Presidential Leave outlined above.

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XIX.

ANALYSIS

Incumbent union presidents who were not City employees were permitted to participate in the city pension plan in violation of IRS law. Evidence shows the arrangements found to violate the Internal Revenue Code raised a number of other legal issues. The City Attorney is preparing a memorandum discussing legal issues that will be mentioned briefly here.

Pension board members owe the pension board a fiduciary duty. Under federal law, "the Taft-Hartley Act, 29 U.S.C. § 186(b) makes it unlawful for any labor representative to 'request, demand, receive, or accept ... any money or thing of value' from an employer." *Carson v. Local Union 52 F. 3d 1173, 1190 (2d Cir. 1995)*.

When union representatives and their union attorneys negotiated the funding levels for the pension plan in 1996 and 2002 on behalf of union members, they may have become pension plan fiduciaries owing a fiduciary duty to the pension plan. Specifically, MEA and Ms. Smith were involved in three rounds of pension fund proposals that raise the question as to whether both were acting as pension plan fiduciaries.

The 17 May 1996 letter from MEA attorney Ann M. Smith shows how the MEA crossed over the line of collective bargaining and asserted domain over the pension-funding interests of those in the pension plan:

I cannot state strongly enough how committed MEA's leadership and Negotiating Team are to the following outcomes: (1) a vast improvement in the retirement formula for general members in view of the resources available to the system (which resources constitute participants' money), and in view of the richness of the present and projected benefits for safety members by comparison; and (2) parity in general salary increases for all CITY employees regardless of job classification.

I also cannot over-emphasize that the level of employee skepticism and distrust regarding any tampering with funding methods related to the retirement system is enormous and will require a yeoman's effort by every person associated with

¹⁰⁰ MEA Memorandum of Understanding; Fire Fighter Memorandum of Understanding; and POA Memorandum of Understanding, Exhibits 58, 59 and 60.

MEA to overcome. MEA will not undertake this formidable task unless the gains in benefit level for the employee MEA represents are clearly respectable and credible rather than de minimus. Frankly, at this juncture the proposal to increase the general member's formula from 1.48% to 1.75% at age 55 is de minimus when contrasted with a proposed safety formula of 3% at 55 and 2.74% at age 50.¹⁰¹

Ms. Smith and the MEA representatives asserted resources in the pension "constitute participants' money." Ms. Smith and the MEA representatives connected the increase in the MEA pension formula with persuading MEA pension participants to go along with "tampering with funding methods." To the extent Ms. Smith and the MEA representatives asserted their domain over this part of the pension plan in 1996 and 2002, they asserted themselves as pension plan fiduciaries.

Courts have held that because federal pension law § 1002(21)(A) (City unions exempt) defines a fiduciary as one with *de facto* authority or control over a plan or its assets, a person who exercises such authority or control by colluding or conspiring with a plan's purported fiduciaries may likewise be considered a fiduciary. In *Landry v. Airline Pilots*, 901 F. 2d 404 (5th Cir. 1990), opinion modified on denial of reh'g, (Apr. 27, 1990), the court found that the employer, the union, and a union representative could be considered ERISA fiduciaries if, as alleged, they had colluded to provide the union representative with retirement benefits to which the representative otherwise would not have been entitled, as an incentive for him to vote against union members' interests.

The presidential benefit transactions would have been considered prohibited transactions under federal pension law. Union presidents cannot receive payments from employers under federal labor law. These reforms were adopted following extensive investigation by the U.S. Senate Select Committee on Investigations in which President John F. Kennedy and former Attorney General Robert F. Kennedy played critical roles.

Unfortunately, municipal unions were exempted from these federal regulations. One aspect of the legal analysis that the City Attorney's Office is currently reviewing would recommend some form of regulation to head off future abuses in the municipal unions and City pension system.

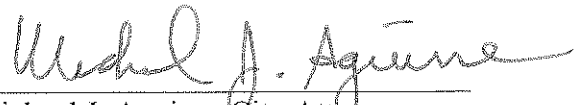
XX.

CONCLUSION

The IRS has determined the Presidential Benefit program violates IRC § 401(a). The determination underscores the need for City officials to fully comply with all applicable IRC

¹⁰¹ 17 May 1996 letter from Ann M. Smith to City of San Diego, Exhibit 11.

provisions. City officials have a duty to address and resolve the issues raised by this Interim Report.

A handwritten signature in black ink, reading "Michael J. Aguirre". The signature is written in a cursive, flowing style. The first name "Michael" is written with a large, prominent "M". The last name "Aguirre" is written with a large, prominent "A". The signature is written above a horizontal line.

Michael J. Aguirre, City Attorney
CITY OF SAN DIEGO